

Guidelines for Kansas Landowners in Creating and Negotiating Equitable Wind Energy Leases

Roger A. McEowen* and Bernard E. Nordling**

*Associate Professor of Agricultural Economics and Extension Specialist, Agricultural Law and Policy, Kansas State University, Manhattan, KS; Member of KS and NE Bars

**Of Counsel, Kramer, Nordling and Nordling, LLC, Hugoton, KS; Assistant Executive Secretary, Southwest Kansas Royalty Owners Association; Member of KS Bar.

The following draft guidelines are being considered by the Wind and Prairie Task Force in response to the task force's charge "to recommend voluntary guidelines or model agreements for land leases for wind-energy development" (Charge #3). They were presented to the task force at the March 19 meeting. Suggestions have been received from the wind industry and discussion is ongoing to incorporate those suggestions into further drafts.

Legal Issues for Landowners

A wind energy agreement should never be negotiated without first having the agreement reviewed by legal counsel. A wind energy agreement is a legally binding agreement that should be reviewed carefully and understood clearly before being executed. It is important to understand that wind energy agreements are long-term agreements that will impact the land subject to the agreement for many years, likely beyond the lifetime of the landowner that executes the agreement.

1. Spotting Issues and Raising Questions.

The following is a list of questions that landowners should ask of a commercial wind energy company when considering any wind energy agreement:

- How much of the land will be subject to the agreement? Care should be taken to limit the land subject to the agreement to just the area that is reasonably necessary for the proper exercise of the company's proposed wind energy development project.
- How long will the land subject to the agreement be affected? What events can trigger early termination of the agreement?
- Does the agreement contain a provision allowing automatic renewals? As a general rule, it is wise to avoid agreements that provide for automatic renewal periods.
- Based on the property rights that are given up, are the proposed payments adequate for the present time and for the life of the agreement?
 - The answer to this question requires an understanding of the mechanics and economics of wind energy production.
- If the agreement offers an up-front lump-sum payment, is the payment representative of a fair amount for the property rights involved?
- What are the tax consequences of the wind energy payments that will be paid under the agreement?
 - The answer to this question depends on tax changes at the federal and state levels, an area of the law that is in a constant state of flux.

DRAFT

- If an easement (rather than a lease) is involved, what are the tax consequences that result from granting a perpetual easement instead of granting an easement for a term of years? The granting of a perpetual easement could constitute a sale of land for tax purposes.
 - Questions concerning the tax consequences of wind energy payments may need to be asked of tax counsel rather than (or in addition to) the wind energy company.
- Does the developer want to develop the land or simply use a portion of the surface for a term of years? Remember, the developer may want to tie-up as much of the land as possible, even though only a portion of the land will actually be used. The developer needs rights over sufficient property to allow the construction of wind turbines and related physical structures, the installation of power lines or cables to carry the electricity to a power company, and access from public roads to and from the land containing the wind turbines and related structures.
 - Does the agreement guarantee that a set number of wind energy turbines will be constructed on the land by a specific date and, if not, is the developer willing to guarantee a minimum amount of payments?
 - Are payments under the agreement based on revenues generated by the wind turbines? Can the landowner get information as to how the owner's revenue will be calculated?
 - Is the developer able to sell or transfer without the landowner's consent any of the land use rights obtained under the agreement? If so, will the original developer remain liable if the new developer or holder of the easement right does not pay the landowner or otherwise defaults?
 - What events trigger the developer's right to terminate the contract? Can the developer terminate the contract at any time without cause? If so, how are payment due under the agreement to be handled?
 - What termination rights does the landowner have? How does the landowner exercise those rights?
 - If the agreement is terminated, whether by agreement of the parties or otherwise, what happens to the wind energy structures and located facilities erected on the property? What is the developer required to remove? How soon must structures be removed? Who pays for their removal?
 - How much compensation is provided to the landowner for roads, power lines and wind rights?

2. Crafting an Equitable Agreement.

When a wind energy agreement is being negotiated, certain issues are critical to the creation of an equitable agreement. Unfortunately, one of the common problems with many wind energy agreements is that once they are proposed and submitted to a landowner, the company wanting to execute an agreement tends to refuse to negotiate changes to the terms of the agreement. **The company's ability to refuse to negotiate terms of the proposed agreement will depend largely on whether a landowner has meaningful options and competent legal representation.**

DRAFT

Key provisions to a wind energy agreement that require careful attention by legal counsel for landowners contemplating a wind farm include the following:

- Is the proposed contract a lease or an easement? If a lease is involved, it should be long enough for the developer to recoup its investment (probably at least 20 years). Does the developer have a right of renewal? If so, does the landowner have the right to renegotiate any of the lease terms? Any lease should not be perpetual – a violation of the rule against perpetuities might be involved (at least in those states, such as Kansas, that have retained the rule).
- If an easement is involved, does the easement include turbine sites, substations, air space, buffer areas, vegetation restrictions, building restrictions, transmissions, and associated rights of way?
- Is a sale of the land contemplated? If so, how is the selling price computed? Any sale price should consist of the fair market value of the land plus the wind energy value. Remember, the granting of a perpetual easement could constitute a sale for tax purposes.
- What is the amount of compensation to be paid? Take care to ensure that the definition of “gross revenue” is done properly. Is it defined as the sale of electrons, sale of green credits or otherwise?
- Is the revenue to be a flat amount annually, an annual payment per tower, a percentage of gross proceeds, a payment of a certain amount of kilowatt hours generated annually, or an amount based on the selling price of megawatts per year, whichever amount is greater? Which revenue calculation method is best for the landowner?
- Is an inflationary factor built into the contract payment provisions? To protect the landowner’s interest, an inflation factor should be built in.
- Does the agreement cover land that will not be needed for the wind farm and related structures? From the landowner’s perspective, there shouldn’t be. Take care to limit the description of the land subject to the agreement to only those areas reasonably necessary for wind energy development. Also, any land not actually used or reasonably necessary for wind energy production should be released from the restrictions of the agreement.
- How long can the land be tied up without any construction of a wind energy facility? Are land use restrictions applicable during this pre-construction phase? If so, a clause should be included compensating the landowner for the reasonable value of those restrictions.
- Must a minimum number of turbines be constructed? Does the agreement call for a minimum payment to the landowner regardless of the number of turbines constructed?
- An up-front lump-sum payment has tax consequences – make sure they are understood.
- What are the intentions of the developer concerning the use of the land? That makes understanding the use provisions of the agreement of primary importance. The construction clause should limit the construction of wind energy structures to not

DRAFT

more than three or four years with adequate compensation paid to the landowner for restricting the use of the land during that time.

- Can the developer assign the agreement? If so, a clause should be inserted that ensures the original developer's liability if the assignee defaults under the terms of the agreement. (Note: Developers want the ability to assign the agreement and subordination language)
- Is the landowner willing to consent to a mortgagee of the developer? If so, a clause should be included that limits the landowner's obligations to the mortgagee.
- Consider including an indemnification clause that indemnifies the landowner for any liability to the wind energy company incurred as a result of activities conducted by third parties (e.g., crop tenants, custom harvesters, and subsurface tenants) on the property.
- What are the landowner's rights concerning usage of the property? Has the landowner reserved rights to use the land for livestock grazing, the raising and harvesting of crops, the construction of improvements that are necessary and incidental to farming or other agricultural activities?
 - The rights of the landowner should be spelled out clearly, with the landowner's rights subject only to the rights of the developer necessary to produce wind-generated power. In other words, the only rights of the wind energy company should relate to the production of wind energy. The landowner should retain full use of the property subject only to those rights.
- How are taxes and utilities to be handled? Is the developer required to pay any increase in real estate taxes as a consequence of the installation of the wind energy facility? Is the developer required to pay all water, electric, telecommunications and other utility service used by the wind facility? Is the developer required to pay all property taxes levied against the wind energy facility?
- Consider the use of a clause that requires the landowner to be treated as favorably as neighbors (consider how to define "neighbor") executing similar agreements.
- Include a clause requiring the removal of all improvements the developer makes upon termination (whether voluntary or otherwise) of the agreement. Relatedly, for developments in some areas, a provision should be included specifying which party gets the rock that gets excavated to build the wind energy structures.
- Require the agreement to be recorded (not just a memorandum of the agreement) to eliminate the necessity of having to locate a copy of the lease in the event of sale or mortgage of the property.
 - Under Kansas law, a wind energy lease agreement, unless it is recorded, is only valid between the parties to the agreement and those that have actual notice of the agreement
- Never agree to confidentiality clauses concerning the terms and conditions of the agreement
- Have the contract reviewed by the landowner's insurance agent for analysis of any additional risks created by the wind energy project. Does the landowners existing comprehensive farm liability policy cover liability for damage to the wind energy structures on the land?
- Will the agreement violate any U.S.D.A. land-use restrictions if the subject land is enrolled in a U.S.D.A. program? If such a possibility exists, consider including in the

agreement a clause requiring the developer to indemnify the landowner for any lost government payments or the imposition of any penalties.

- Evaluate the agreement with an eye toward the risk faced by the landowner. That includes environmental concerns, issues that could be raised by neighbors (i.e. nuisance-related concerns), and potential violation of applicable zoning and set-back requirements. It is probably a good idea to require the developer to maintain liability insurance coverage related to wind energy activities on the land. The landowner should be named as an additional insured, and the policy should provide that it cannot be cancelled by the developer without prior written notice to the landowner.
- What does the agreement provide for if the property is condemned? Which party receives any condemnation payments?
- Of particular concern is a provision in many wind energy agreements under which the landowner agrees to indemnify and reimburse the developer if a third party on the property with the landowner's permission damages the wind farm structures. For example, if a landowner contracts with a custom cutter to harvest wheat on the premises that is also subject to a wind energy lease and the custom cutter's activities set the wheat field on fire that causes damages to the wind farm structures, the landowner, under such an indemnification provision, is liable for the resulting damages.
 - From the landowner's perspective, such a clause should not be included in the agreement. Indeed, such clauses are typically not included in oil and gas leases in Kansas.
- Another concern is that with some wind energy agreements, the developer the landowner executes the contract with is a shell corporation created for liability purposes.

Summary

While, wind farming has the potential to provide significant economic benefits for rural landowners, substantial peril exists for landowners that don't ask the proper questions and don't successfully negotiate unfavorable terms in wind energy leases. Clearly, any proposed lease agreement should be evaluated by legal counsel, and an attempt should be made to negotiate any unfavorable terms. Failure to do so could result in many years of dissatisfaction.